DEPARTMENT OF STATE REVENUE

04-20200377.LOF

Letter of Findings: 04-20200377
Gross Retail and Use Tax
For the Years 2014, 2015, and 2016

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Aircraft Service Provider established, in part, that it was entitled to an adjustment of an audit assessment of sales and use tax; Provider documented that it was not subject to tax on equipment and parts resold to its customers or on items consumed in its business of repairing and refurbishing aircraft.

ISSUES

I. Gross Retail and Use Tax - Purchase for Resale.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-8(b); IC § 6-8.1-5-1; *Rhoade v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466 (Ind. Tax Ct. 1993); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-3-4.

Taxpayer argues that it was not required to pay sales tax or self-asses use tax on the purchase of equipment and supplies that were later resold to one of Taxpayer's own clients.

II. Gross Retail and Use Tax - Exempt Services.

Authority: IC § 6-2.5-1-20.3; IC § 6-2.5-4-6; 45 IAC 2.2-4-2.

Taxpayer maintains that it was not required to pay sales tax or self-assess use tax on the purchase of exempt services.

III. Gross Retail and Use Tax - Aircraft Repair or Refurbishment.

Authority: IC § 6-2.5-5-46.

Taxpayer states that it was not required to pay sales tax on the purchase of materials used in its business of repairing and refurbishing aircraft.

IV. Ten-Percent Negligence Penalty - Administration.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer asks that the Department exercise its authority to abate the ten-percent negligence penalty on the ground that Taxpayer did not act with willful negligence in determining its tax liabilities.

STATEMENT OF FACTS

Taxpayer is an Indiana aircraft dealer, repair facility, and aviation fuel station. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records and tax returns.

The audit assessed additional sales tax on Taxpayer's purchases from a number of vendors. The audit also assessed use tax on purchases of items for which no sales tax was paid and for which Taxpayer did not

self-assess use tax.

The Department's audit resulted in an assessment of additional sales/use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted by video conference during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Use Tax - Purchase for Resale.

As a threshold issue, tax assessments are *prima facie* evidence that the Department's assessment of tax is presumed correct; the taxpayer bears the burden of proving that the assessment is incorrect. IC § 6-8.1-5-1(c).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "use tax." In this context, "use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoade v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id*. at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 469 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a). A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. *See* IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), IC § 6-2.5-3-2(a).

Specifically, the use tax is imposed under IC § 6-2.5-3-2(a) which states:

> An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

45 IAC 2.2-3-4 provides:

> Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. In this case, the Department determined that Taxpayer had acquired tangible personal property, including an aircraft, in retail transactions and used that property in Indiana without paying sales tax at the point of purchase. The Department therefore issued proposed assessments for use tax, as provided by 45 IAC 2.2-3-4.

Taxpayer protests that the sales in question were for resale and were not subject to use tax. IC § 6-2.5-5-8(b), provides in relevant part:

> Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

IC § 6-2.5-5-8(b) like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

Taxpayer argued that its purchase of an aircraft from "AeroMech" Inc. was exempt from sales tax and use tax on the ground that the aircraft was purchased for resale. In this instance, the Department must disagree with Taxpayer because the aircraft was listed as a depreciable asset as of December 31, 2014.

However, a review of the documentation provided by Taxpayer does indicate numerous other items which were purchased for resale all of which will be removed from the use tax projection.

FINDING

Taxpayer's protest is denied in part and sustained in part.

II. Gross Retail and Use Tax - Exempt Services.

DISCUSSION

45 IAC 2.2-4-2 contains a provision exempting the purchase of services from sales tax. 45 IAC 2.2-4-2(a) states that, "Professional services, personal services, and services in respect to property not owned by the person rendering such services are not transactions of a retail merchant constituting selling at retail, and are not subject to gross retail tax." However, "Where, in conjunction with rendering professional services . . . the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail . . . ." *Id*.

Taxpayer paid its vendor, Millennium Technologies, for the installation and subsequent use of a broadband Internet line located at the Taxpayer's business headquarters. According to Taxpayer, this access allows its customers to "transmit credit card, debit card, and other financial to credit and debit card processing networks." Taxpayer explains that it sends its data to financial institutions outside Indiana.

Taxpayer concludes that the monthly Millennium charges are exempt under IC § 6-2.5-4-6 which provides:

(a) A person is a retail merchant making a retail transaction when the person:
(1) furnishes or sells an *intrastate telecommunication service*; and
(2) receives gross retail income from billings or statements rendered to customers.
(b) Notwithstanding subsection (a), a person is not a retail merchant making a retail transaction when:
(1) the person furnishes or sells telecommunication services to another person described in this section or in section 5 of this chapter;
(2) the person furnishes telecommunications services to another person who is providing prepaid calling services or prepaid wireless calling services in a retail transaction to customers who access the services described in section 13 of this chapter;
(3) the person furnishes intrastate mobile telecommunications service (as defined in IC 6-8.1-15-7) to a customer with a place of primary use that is not located in Indiana (as determined under IC 6-8.1-15); or
(4) the person furnishes or sells value added nonvoice data services in a retail transaction to a customer.
(c) Subject to IC 6-2.5-12 and IC 6-8.1-15, and notwithstanding subsections (a) and (b), if charges for telecommunication services, ancillary services, Internet access, audio services, or video services that are not taxable under this article are aggregated with and not separately stated from charges subject to taxation under this article, the charges for nontaxable telecommunication services, ancillary services, Internet access, audio services, or video services are subject to taxation unless the service provider can reasonably identify the charges not subject to the tax from the service provider's books and records kept in the regular course of business. (*Emphasis added*).

Since Taxpayer is located in Indiana and - according to Taxpayer - its Internet traffic is directed solely to and from Florida - Taxpayer concludes that the charges are exempt under IC § 6-2.5-1-20.3 which states:

"Intrastate telecommunications service" means a telecommunications service that originates in a particular state, territory, or possession of the United States and terminates in that same state, territory, or possession.

Taxpayer argues that since the Millennium Internet line connects its Indiana location and a specific Florida location, the Millennium charges should be exempt from sales tax. However, there is nothing in the Millennium contract or the documents provided that establish that Taxpayer's Millennium Internet service operates on a private, dedicated line between a location in Indiana and a location in another state. In addition, the agreement with Millennium also calls for it to provide Taxpayer tangible personal property such as a router, category 5 wire, wall jack, "appropriate cable," and other "minor materials" to complete the installation. As provided for in IC §

6-2.5-4-6(c), the undifferentiated bundling together of taxable charges and exempt charges "are subject to taxation . . . ."

However, Taxpayer has provided documentation establishing that amounts it paid for flight safety training, model drawing, and certain software represented the purchase of exempt services and should be removed from the use tax projection.

FINDING

Taxpayer's protest is denied in part and sustained in part.

III. Gross Retail and Use Tax - Aircraft Repair or Refurbishment.

DISCUSSION

Taxpayer argues it was not subject to sales or use tax on the purchase of bungee cords from a vendor called SBC Industries because the bungee cords were to be "used in the aviation repair shop to hold parts steady and open as they repair aircraft."

In support of its position, Taxpayer cites to IC § 6-2.5-5-46 which provides in relevant part:

(a) Transactions involving tangible personal property (including materials, parts, equipment, and engines) are exempt from the state gross retail tax, if the property is:
(1) used;
(2) consumed; or
(3) installed;
in furtherance of, or in, the repair, maintenance, refurbishment, remodeling, or remanufacturing of an aircraft or an avionics system of an aircraft.
(b) The exemption provided by this section applies to a transaction only if:
(1) the retail merchant, at the time of the transaction, possesses a valid repair station certificate issued by the Federal Aviation Administration under 14 CFR 145 et seq. or other applicable law or regulation; or
(2) the:
(A) retail merchant has leased a facility at a public use airport for the maintenance of aircraft and meets the public use airport owner's minimum standards for an aircraft maintenance facility; and
(B) work is performed by a mechanic who is certified by the Federal Aviation Administration.

Taxpayer supplied a copy of its "Repair Station Certificate" called for in IC § 6-2.5-5-46(b)(1).

The Department agrees and concludes that "[t]he bungee cords are tangible personal property, used in the repair shop to assist in performing repairs and refurbishing aircraft" and fall within the exemption provided under IC § 6-2.5-5-46.

FINDING

Taxpayer's protest is sustained.

IV. Ten-Percent Negligence Penalty - Administration.

DISCUSSION

Together with the imposition of additional sales/use tax, the Department assessed an additional 10 percent negligence penalty.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id*.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

Taxpayer states its "failure to pay sales tax on certain purchases [was] a result of unforeseen circumstances." Taxpayer explains that during the years at issue, one of Taxpayer's owners became ill and eventually passed away. "The loss of such a key person to the business left a huge hole in the business, missing records and issues related to accounts payable and finance the hardest." As a result, many of Taxpayer's records were lost or misplaced. Following the audit, Taxpayer states that it has "searched for and located many invoices and records showing that sales tax should not be assessed."

The Department believes that Taxpayer erred in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's position was so egregious as to constitute "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that, under IC § 6-8.1-5-1(c), Taxpayer has met its burden of establishing that the penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest is sustained in part and denied in part. The original sales and use tax assessments were approximately $39,000. Based on the conclusions set out in this Letter of Findings, the assessment will be reduced by approximately $9,900 the specific details of which will be provided as an addendum accompanying this Letter of Findings.

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An html version of this document.